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# CORPORATE BEHAVIOUR IN RESTRAINT OF TRADE IN GOODS AND SERVICES IN SRI LANKA

Report prepared by

F. D. C. WIJESINGHE, MSc (Econ)*

* Mr. F.D.C. Wijesinghe was former chief economist at the Fair Trading Commission of Sri Lanka. The views expressed in this report are those of the author and they do not necessarily reflect the views of UNCTAD or any other part of the United Nations system. The report is reproduced as received and the designations are those of the author. The designations used do not imply the expression of any opinion whatsoever on the part of the UNCTAD secretariat concerning the legal status of any country, area or territory, or of its authorities, or concerning the delimitations of its frontiers.

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# CORPORATE BEHAVIOUR IN RESTRAINT OF TRADE GOODS AND SERVICES IN SRI LANKA

## Sri Lanka - basic data

| | |
|---|---|
| Geographical situation: | 20 miles east of the southern-most extremity of peninsular India |
| Area: | 25,332 square miles |
| Population: | 16.8 million (1989) |
| National income: | GNP at current factor cost 222,467 million rupees (1989) |
| | GNP per capita - 13,237 rupees (1989), US$ 367.00 |
| Exchange rate: | Average in 1989 US$ 1 = 36.05 rupees<br>SDR 1 = 46.19 rupees |
| Trade: | Imports - rupees 80,225 million (1989)<br>Exports - rupees 56,175 million (1989) |

## COMPETITION AND THE CORPORATE SECTOR

A contrast in attitudes towards competition should be mentioned at the outset. The average educated Sri Lankan does not have much faith in competition as a panacea for the ills of the economy. The same may hold true in most developing countries in South Asia. However, this view is not prevalent in the developed countries. According to The Economist of 13 July 1990, the watchword in the trade war between the United States of America and Japan is "competitiveness". In the past few years a new (and appropriately competitive) industry has grown up around this concept. "Councils, think tanks, business schools, professions, politicians, all stand ready with quotes, pamphlets, books and conferences offering their patent remedies on how to improve their nation's competitiveness". Likewise the Government of the United Kingdom has outlined its policy on competition as follows:

> "Competition is an essential element in the workings of marketing. It encourages enterprise, product and choice. In doing so, it enables consumers to buy the goods they want at the best possible prices. By encouraging efficiency in industry, competition in the domestic market also contributes to our international competitiveness."1/

Until the late 1930s, Sri Lanka (then Ceylon) enjoyed an economy mainly based on colonial plantations with only 11 foreign and 19 locally registered companies (in 1931) engaged in export/import trade, industries and local distribution. They were able to cater to the needs of the population of 5,306,871 (in 1931). With the expansion of population and more people venturing into other areas of economic development, particularly in the mineral sector, the number of companies listed with the Registrar of Companies had risen to 956 (178 foreign companies and 778 local companies) at the end of 1947. The increase in the number of registered companies grew faster than the increase in population, which stood at 6,657,339 at the end of 1947. After

Independence in 1948, Sri Lanka experienced rapid economic growth with an increase in population which stood at 16.8 million at the end of 1989. The registered companies had risen to 17,721, showing rapid growth in the availability of savings ready for investment.

Most of the companies in business today are privately owned - numbering 15,349 - while public companies accounted for only 1,427, of which only 177 companies are registered with the Colombo Stock Exchange. With financial facilities made available to the public through various sources, according to the Registrar of Companies, there has been a substantial increase in the number of companies registered during the past few years.

Two ordinances of the Parliament of Sri Lanka passed in 1987 have had a considerable impact on corporate behaviour. The first is the Fair Trading Commission (FTC) Act No.1 of 1987 and the second is the Securities Council (SC) Act No.36 of 1987. The FTC succeeded the National Prices Commission. While the Prices Commission was only concerned with surveillance of prices of "prescribed" articles, the FTC, while continuing the Prices Commission's price surveillance function, has also been concerned with promoting competition between providers of goods and services.

The primary objective of the SC Act is to encourage the market in which securities are traded in an orderly, efficient and fair manner, while protecting the interests of the investor. Its secondary objective is to develop a securities market, in particular, and a capital market, in general, by widening share trading, encouraging listed companies to seek more capital from the market to finance growth and new investment, promote more companies to seek listing and divert more savings of the public and fixed deposits to shares by promoting establishment of unit trusts, venture capital companies and merchant banks.

The institutions set up by these two ordinances both promote competition - the FTC directly and the SC indirectly. The FTC is there to prevent monopolistic behaviour by a dominant firm as well as mergers which are contrary to the public interest and other forms of anti-competitive behaviour. The SC prevents anti-competitive practices by a listed company such as insider-dealing and manipulative practices.

## THE COMPANIES ACT

The Companies Act No.17 of 1982 sets out the procedure for the establishment of a company of any nature. The activities of the company are limited to those given in the Memorandum and Articles of Association where the owners of the company are required to specify in detail the activities of the company and the limitation to such activities. These limitations as given in the Articles and Memorandum, can be changed to suit the owners in keeping with the changing economic pattern, upon proper notification to the Registrar of Companies. This applies to foreign investors and to those who seek registration of liaison offices in Sri Lanka. At present, registration of liaison offices is permitted only to facilitate Sri Lanka exports, manage development projects, [illegible], but not for the promotion of foreign investors' own exports in Sri Lanka.

## MONOPOLY AND MERGER OF COMPANIES

Section 15 read with section 11 of the Fair Trading Commission Act No.1 of 1987 makes it permissible for a trader to engage in anti-competitive practices and also allows monopoly situations and mergers if they are not likely to operate against the public interest.

According to Section 11, "The Commission may, either of its own motion or on a complaint made to it by any person, or in the case of a proposed merger on a request made to it by any person, carry out an investigation with respect to:

(a) the existence or possible existence of a monopoly situation;
(b) the creation or possible creation of a merger situation;
(c) the prevalence of any anti-competitive practice."

Under Section 15, " (i) Upon the conclusion of an investigation carried out in respect of any or all of the matters specified in section 11, if the Commission is of the opinion:

"(a) that any monopoly or merger situation or anti-competitive practice exists but such monopoly or merger situation or anti-competitive practice does not operate or is not likely to operate against the public interest, or in the case of a proposed merger that such proposed merger is not likely to operate against the public interest the Commission may, by order, authorise such monopoly or merger situation or anti-competitive practice or the proposed merger ...".

Section 23 of the Consumer Protection (CP) Act No.1 of 1979 also makes it permissible for a trader to engage in anti-competitive practices if the FTC "considers it expedient in the interest of the national economy ...". There are companies which have taken advantage of these provisions in the law.

The provision in the CP Act just quoted and the provision of the FT Act, when read together, could allow a company to engage in certain anti-competitive practices and also allow merger of companies. One is led to believe that the authorities concerned would have taken into consideration the size of the local market and availability of raw materials within the reach of such companies.

On the other hand, Section 208 of the Companies Act No.17 of 1982 makes it very clear that amalgamation of any two or more companies is possible after referring such arrangement to the Court and with its approval. There is, however, nothing to prevent a company acquiring, or shareholders of a company acquiring, controlling shares of another company. This may be another reason why some public companies are still reluctant to float their shares on the Stock Exchange.

Section 55 of the Companies Act prohibits a company from giving, whether directly or indirectly or by means of a loan, guarantee, provision of security or otherwise, any financial assistance for the purchase of, or in connection with the purchase of, shares where the company is a subsidiary.

## PRIVATIZATION

It has been decided to privatize almost all government-owned business undertakings so that there may not be any government monopoly except where public enterprises have to be managed by the Government in the national interest, such as power and energy. Already the Government has privatized certain entities by issuing shares to the public of a number of business organizations and industries where the Government had had the sole monopoly. The private sector is allowed to operate bus services. The whole road transport service will be privatized soon.

## FINANCIAL MARKETS

Evidence of interest by foreign investors in the Colombo Stock Market (CSM) is indicated by the upsurge in share trading - from a monthly turnover of 18.8 million rupees in 1989 to more than 180 million rupees in June 1990. Similarly, share prices have moved up sharply from a monthly average of 181.5 (base 1985) in December 1989 to 357.7 in June 1990 - an increase of more than 100 per cent.

A 100 per cent tax on share purchase by non-residents has been removed, effectively opening the market to foreign investment. However, the removal of the tax is subject to a limit of 40 per cent, if any non-resident's share holding is in an individual company. After 40 per cent, the 100 per cent stock transfer tax still applies. Investors must also be aware that foreign exchange controls are still in place. Transfer of funds for investment purposes into and out of the country must be approved by the Government. The administration has not detailed its intentions on the controls.

There appears to be an anti-competitive practice at the Colombo Stock Exchange. The management has withdrawn intercom facilities from the public gallery in a move, perhaps, to prevent small-time investors from patronizing the Stock Exchange. This facility had been available to small investors to contact their brokers direct and to watch the trend of the share market on the Trading Floor. Most of these small investors have no telephone facilities at their residences by which to contact the brokers and thereby avoid going to the Trading Floor - particularly in view of the fact that the brokers' offices are now quite far from the Stock Exchange Trading Floor. Moreover, most of these small investors are retired persons who make use of the savings of a lifetime from their provident funds or commuted pensions to invest in quoted companies since they fear to put their savings in finance companies after the recent spate of bankruptcies. It is part of the functions of the Stock Exchange to facilitate the mobilization of the funds of small savers. If the Colombo Stock Exchange is to perform this function adequately, better facilities should be provided for small investors to participate on the Trading Floor.

## DIRECT FOREIGN INVESTMENT

Direct foreign investment, which is largely or entirely export-oriented, is promoted by the Greater Colombo Economic Commission which operates in the two Investment Promotion Zones of Katunayake and Biyagama. The main features of the Greater Colombo Economic Commission's tax financial incentive package are as follows:

(i) No restrictions on equity ownership

(a) The project may be 100 per cent foreign-owned. Joint ventures with local companies are also welcome;
(b) Shares can be freely transferred within or outside Sri Lanka;
(c) Dividends can be remitted without tax or exchange control restrictions;
(d) Capital and proceeds of liquidation are repatriable without tax or exchange control restrictions.

(ii) Tax exemption of 100 per cent for up to 15 years

(a) A company can qualify for 100 per cent exemption from corporate income tax for up to 15 years, depending on project characteristics;
(b) After the tax exemption period, concessionary taxation is available for up to 15 years.

(iii) Other tax exemptions

(a) No tax on royalty remittance during the exemption period;
(b) Tax exemption on earnings of expatriate staff for the duration of the tax holiday;
(c) Double taxation relief;
(d) Import of construction materials, plant, equipment and raw materials and export of the final products or semi-finished goods are free of duty.

The contracts of establishment of foreign firms in the Investment Promotion Zones have been examined and no clauses which could later lead to output limitations or restraints on markets for exports have been found.

Although in theory, preference is given to foreign firms which make use of local raw material, a sample survey done in 1981 of 30 Greater Colombo Economic Commission firms (22 in the garment sector and eight in non-garment sectors) showed that the utilization of local inputs in total raw material usage in Free Trade Zone enterprises was only 5 per cent. Garment manufacturing firms, which account for 93 per cent of the total raw material used in the zone enterprises, utilized only 3 per cent of local raw material in 1981. Local resource-based industries, such as cashew products, rubber products, tea packaging, etc. accounted for only 2 per cent of total raw material usage. Although Greater Colombo Economic Commission had firms have shown some improvement in the use of local raw material in the post-1981 period, this was still below 10 per cent. However, production in the Investment Promotion Zones is not derived essentially from imported inputs because of any restrictive clauses in the contracts of establishment.

Foreigners can own 100 per cent share capital of a company in the Free Trade Zones and they are at liberty to sell their shares.

The functions of the Foreign Investment Advisory Committee, which dealt with foreign investments outside the Free Trade Zones, are now amalgamated with the Greater Colombo Economic Commission. Foreign investors would naturally prefer to locate their industries in the same area where raw materials - particularly those which are heavy and expensive to transport - are available. Nevertheless, such investors are given only a maximum of 10 years tax holiday compared to 15 years in the Free Trade Zones. This sort of discrimination against an investor who uses local raw materials seems unfair. The investors in the Free Trade Zones largely import their requirement of raw materials.

## CONCESSIONAL FINANCE

Under the present economic policy of the Government, financial assistance on concessional terms from the Medium and Long Term Credit Fund of the Central Bank (MLCF) and Small and Medium Scale Industrial Credit Guarantee Scheme (SMI) of the National Development Bank (NDB) is provided to investors. Likewise, the Development Finance Corporation of Ceylon (DFCC) and commercial banks provide assistance by way of loans and equity participation. The Export Development Board also provides financial assistance to export-oriented projects. The National Development Bank extends financial assistance to industrial projects by way of loans and equity participation. In 1989, the National Development Bank approved 144 such projects with an outlay of 1,084 million rupees for direct financial assistance. Commercial banks have continued to provide financial facilities for industrial purposes; this amounted to 12,536 million rupees in 1989.

Under the New Comprehensive Rural Credit Scheme (NCRCS), credit institutions are continuing to provide short-term cultivation loans at concessionary rates of interest with the support of the Central Bank which gives 100 per cent re-finance and 50 per cent credit guarantees. In addition, the Central Bank also grants financial facilities for medium- and long-term investment covering a wide range of economic activities in the agricultural sector through 28 credit schemes, with a view to alleviating rural poverty. Cooperative banks are also in operation. Financial assistance extended by the Central Bank and other agencies now covers all sectors of the Sri Lankan economy.

However, liquidity pressure on commercial banks has kept the inter-bank call money market rather high throughout the whole of 1990, a situation likely to continue for some time. Nevertheless, the banking facilities extended under the Praja Niyamaka Scheme introduced in October 1988 for the purpose of extending financial facilities to village areas as a forerunner to the promotion of Agency Banking proved to be successful.

## JOINT VENTURES

Instead of exporting raw materials, Sri Lankan investors are now looking for foreign collaborators with technical know-how. Some have been extremely successful in this regard. One good example concerns activated carbon derived from coconut shell charcoal. Sri Lanka had been exporting coconut shell charcoal as raw material to Japan and Germany for a long time, but had earned very little foreign exchange. A study made by the Japanese Chemical Association, found that Sri Lanka coconut shell charcoal contains less ash and sand than other sources and that it is ideally suited for production of activated carbon. The Japanese brought their technical know-how and Sri Lanka is now exporting activated carbon in large quantities.

This type of investment by foreigners is made possible because of the new policy measures of the Government. Foreigners can hold 40 per cent shares of any local company outside the Free Trade Zones. They are also permitted to expatriate their profits. Owing to the high cost of production and transport of raw materials, as well as the double handling charges, foreigners prefer to manufacture the final products close to the sources of raw materials. This is especially so in regard to raw materials which are categorized as dirty-cargo by the shipping lines.

## INDUSTRIAL POLICY

A new industrial strategy was introduced by the Ministry of Industries and approved by the Cabinet on 27 December 1989. The new strategy seeks to:

(a) Transform import-substituting industry into export-oriented industry;
(b) Provide greater employment and income opportunities;
(c) Diversify the economy and strengthen the balance of payments;
(d) Ensure a more equitable distribution of income and wealth.

The strategy also includes policy measures aimed at: mobilizing resources for investment and exports; encouraging foreign and local investment; reforming public enterprises; promoting a competitive environment; establishing a linkage between large and small industries; promoting research, training and marketing; and removing administrative obstacles to investment, production and exports.

As far as the Fair Trading Commission is concerned, the new industrial policy has resulted in a fairly drastic reduction in the number of "prescribed" articles, from 43 to 26, that is, the Commission's price surveillance function will be confined to only 26 articles, 17 articles having been removed from the list of commodities, the manufacturers of which are obliged to submit for the Commission's consideration any variation in prices.

## FINANCE - LACK OF COMPETITIVE AVENUES TO INVESTMENT

A vast number of new finance companies have mushroomed in the past 20 years. Before introduction of the first Finance Companies Act No.27 of 1979, all that an individual had to do before starting business as a finance company operator was to seek registration under the Companies Law. This was cheap and relatively easy. After registration, even if he had no capital to put up, all he had to do thereafter was to insert a large advertisement in the newspapers promising very high rates of interest, with leading captions on security and stability, and deposits would flow in thereafter.

As a result, in the 1970s, a large number of companies were able to start business with relative ease. A most important factor that influenced the growth of finance companies was the lack of relatively attractive alternative investment possibilities in a society where the habit of saving and investment was fast growing. Sri Lankans who had worked in the Middle East found investment in finance companies very attractive.

Commenting on the management of the new finance companies, the Governor of the Central Bank, Dr. Karunatilleke, has stated: 2/

> "As long as deposits came in, the new finance companies were not faced with difficulties in meeting regular commitments to their depositors. For many companies the need for profitable investments was not the main consideration, but a continuing cash flow. To ensure the latter, many companies entered into major advertising campaigns which were beyond their means. As there was the expectation that there would be an uninterrupted flow of funds, a large number of companies did not pay sufficient attention to build up sound assets portfolios with adequate margins to service the commitments to depositors.

"Equally, the avenues for high-yielding investments for depositors' funds were relatively few and many companies who obtained deposits from the public did not find it easy to repay because their investments did not bring in high returns. Several companies fell into difficulties with a reduction in the rate of flow of new deposits, particularly after 1984 and they did not have sound investments with very high yields which could meet their commitments. This position was aggravated in the period 1986-87 when a virtual ceiling on the rate of interest on deposits, which was substantially below the actual rates paid by companies, resulted in a sharp reduction in the flow of funds into finance companies."

To enable finance companies to pay depositors over 30 per cent, the company had to charge the borrower 45 to 50 per cent per annum. Apart from money lending in the unofficial money market, the only area with very high yields has been in passenger vehicle and private motor car finance.

Anti-competitive practices by finance companies are legion. Many finance houses in difficulty had followed the unsatisfactory practice of providing funds to their own subsidiaries. This would at least have had some justification if the companies concerned were making profits and were efficiently managed. On the contrary, the performance of these subsidiaries was dismal and the companies obtaining loans at specially favourable rates of interest were making big losses. Hence there were no returns on the investment.

In early 1989, the Central Bank set up a new department for the supervision of non-bank financial institutions. This department has, with the the concurrence of the Monetary Board of the Central Bank, introduced certain maximum deposit interest rates for finance companies "in order to prevent excessive competition between finance companies". According to Direction 2 of 1989 on Rates of Interest and Other Charges, the maximum annual rate of interest payable on 12 months deposits is 20 per cent per annum, and the maximum interest payable on longer time deposits is 24 per cent. Although on the face of it, this may seem to be an anti-competitive practice, the control seems justifiable in view of the number of depositors, in finance companies who have suffered the loss of a lifetime's savings.

According to Dr. Sirisena, Director of the new department:
"The competition between the finance companies has to be largely on the quality of services they offer to depositors and borrowers. The price competition, particularly in respect of interest rates paid on deposits has to be within a narrow range."3/

## AUCTION SYSTEM

The main commodity accounting for nearly 80 per cent of Sri Lanka's total exports prior to 1900 was tea. The major buyers were the British tea giants. Planters, however, felt that they were not getting a correct price and that the international price was not reflected in the offers they received from the buyers. Moreover, they found that they could get a better price if they shipped their tea to the London Auctions which commenced in 1877. In order to get the best price possible and also to enable the buyers to obtain the required quality grades in the quantities they needed, the auction system was introduced in Sri Lanka in 1883 on the same pattern as in London. Yet some planters continued to ship their tea to the London auction on long-term contract bases.

A tea auction is quite different from other commodity auctions. The quality of tea coming from different estates, and very often from the same estate, depends on elevation, windward side or leeward side, soil, availability of rainfall, etc. Therefore, samples are made available to the prospective buyers in advance so that they may know the different quality grades of tea and the quantities of a particular grade offered at the auction. The requirement of buyers depends on the blend they have tested: some may require a large quantity of a particular grade while others may require only a small quantity.

At the auction tea is offered in lots, not in small parcels, and therefore the buyer has to buy the entire lot of a particular quality grade coming from an estate. There may be other buyers who do not require large quantities of that particular quality. They therefore make known to the prospective buyers the quantities they need of a certain grade and thus share the lot among themselves depending on their requirements for a particular blend. This cannot be considered "collusive" bidding. Anyone can bid at the auction. At the auction, as the hammer falls, they have to indicate their individual requirements by raising their hands and registering the quantities they need. They all pay the same price irrespective of the quantity they need. This is a perfect auction system where the need of the smaller buyer is also served satisfactorily. What happens after the purchase at the auction will be dealt with later.

Dessicated coconut was also sold under auction for some time. In order to remove certain forms of malpractice among dealers, this item has now been withdrawn from the auction system, as buyers need large quantities of different cuts: for example, the Mars Cut is required only by Mars Chocolate Company. Copra is still under the auction system. Supervision by the Ceylon Chamber of Commerce ensures that anti-competitive practices such as collusive bidding are avoided.

## TECHNOLOGY SUPPLY

Technology is not desired for its own sake. It is desired only if it has the power to produce something which is in demand. The development of technology is both costly and risky. Therefore, unless the economic environment makes it viable to invest in technology development, it is unlikely that resources would be available for such development.

The development of technology in Sri Lanka is risky owing to the limited size of the market, the type of product and the level of competition. No manufacturing activity can depend solely on equipment designed for development in Sri Lanka. It has been observed that: "In the absence of a technology development base, it would be advantageous from an efficient resource-user point of view, to import technology initially for mastery through usage in industry and for redesigning and adaptation - subsequently."[4/]

Investment in research and development by the private sector has been constrained by high risk owing to instability, non-predictability, etc., and public sector research and development institutions have failed to satisfy domestic technological needs. Market forces, however, call for competitive quality and price. Imported technology is costly. This makes for a conscious policy for development of local technology and innovation essential.

Although wide-ranging discussions have been held with the Greater Colombo Economic Commission which licenses foreign investment, there are no known cases of restrictive clauses in licensing agreements with foreign investors who supply technology, taking advantage of their dominant or monopoly position in the market in question.

In Sri Lanka, information on technology has not been readily available in the past to guide investment and operational decisions. Identification of market prospects, investment opportunities, available technical options, sources of technology and their prices, emerging technological innovations, etc., has been constrained by the absence of a technology information base. However, this situation is expected to change with the new White Paper on Industry, "A Strategy for Industrialisation in Sri Lanka". Steps have already been taken to implement para. 9.1. of the White Paper which states:

> "with the promotion of a competitive environment in industry, the demand for technology will increase. The Government will play a catalytic role in the transfer of relevant technology by assisting industries to identify, procure and absorb new technologies which will enhance Sri Lanka's competitive advantage. Acquisition of technology will be promoted by stimulating foreign investment which will be used as a vehicle for the transfer of technology."

## INSURANCE

The Government de-regulated the insurance industries a few years ago and permitted the private sector to start insurance companies in competition with the State sector. However, despite assurances given to the private sector that they would be allowed to compete on equal terms, the regulations (which apply only to the private sector) are such that the State sector has the following advantages which make competition by the private sector difficult:

(a) Appointment of institutional agents

The Control of Insurance Act No.25 of 1962 permits insurers to appoint only individuals as agents. Private insurers have to comply with this Act. The State insurers, however, continue to appoint institutions as agents. This enables them effectively to give rebates equivalent to agency commission on the premium, and hence have a special pricing advantage.

(b) Payment of commission

The Insurance Regulations promulgated under the Control of Insurance Act lay down maximum rates of commission and brokerage that the insurers may pay the agent or broker. These limits do not apply to the State insurers, thus enabling them to offer higher rates of commission. This gives them a special advantage.

(c) Compliance with tariffs

The Control of Insurance Act and the Insurance Regulations empower the Controller of Insurance to fix minimum and maximum premium rates. Under the power so vested, the Controller of Insurance has directed private insurers to adhere to market rates of premium and, where applicable, to the relevant tariff rates. There are tariffs for Fire, Motor and Workmen's Compensation Insurance. A similar directive does not seem to exist for the State insurers. In the absence of such a directive, the State insurers obviously have a competitive advantage since they are able to change rates without any restrictions.

(d) Credit

The Control of Insurance Act stipulates that the insurer shall not be liable to pay any amount owing under any policy of insurance unless the full premium due is paid at the time it is due or there is a bank guarantee. The latter is permitted only up to a maximum of 30 days. State insurers are known to provide credit on the basis that neither this Act nor the Regulations apply to them.

(e) Compulsory sessions

Under the Control of Insurance Act, private insurers are obliged to cede to the National Insurance Corporation (NIC) 15 per cent of every fire and marine policy written by them. It appears that the commission paid by the NIC for this business is far below the rates of commission received by private insurers from their professional insurers. Apart from the loss in competition, the position is anomalous because the NIC is also a competitor to the private insurer. Further, the Insurance Corporation of Sri Lanka (a State insurer) does not cede 15 per cent to the NIC.

(f) Powers of Control of Insurance

The Controller of Insurance has been vested with power to ensure that the private insurers transact insurance business in conformity with the Control of Insurance Act and related Regulations. The Controller of Insurance does not appear to have similar authority over the two State insurers.

(g) Monopoly of Government/corporation business

Government business and that of public corporations have to be written by either of the two State insurers. Private insurers are precluded from participation in this business.

## EXPORT FINANCE AND GUARANTEE

The Sri Lanka Export Credit Insurance Corporation (SLECIC) was set up by Act No.15 of 1978. Before the Corporation was set up, new and small-scale exporters were obliged to obtain credit from commercial banks. Banks were often reluctant to make available finance to exporters who did not match their standard of credit rating. If the buyer did not pay the dues or was insolvent, the exporter suffered the full loss. Often banks had to suffer the full loss for financing the exporter at pre- and post-shipment stages.

The Corporation commenced operations in February 1979. It operates on a "no loss, no profit basis". SLECIC underwrites export credit risks and also risks arising from non-payment or delayed payment. SLECIC is a member of the International Union of Credit and Investment Insurance called the Berne Union. The Berne Union comprises 40 export credit insurers, both public and private institutions. There are certain basic principles universally accepted by these export credit insurers:

(a) Co-insurance which indicates that 100 per cent cover should not be accepted. The individual or firm insuring should also bear a certain percentage of the loss.

(b) The loss is indemnified to the insured if the terms of the contract are fulfilled. Therefore, recoveries should follow.

(c) Export credit insurance is a means of protection for exporters.

The credit insurer underwrites insurable risks and takes on calculated risks. He does not take on blind risks. As SLECIC is a public institution, risks have to be carefully minimized and only risks beyond the control of the exporter and the buyer are paid out as claims by SLECIC.

The Berne Union fixes the minimum interest rates that their members can levy. In other words, as far as interest rates are concerned, there can be no competition between the various export credit guarantee organizations which are members of the Berne Union. It is worth investgating whether the Berne Union is guilty of restrictive business practices in that it does not permit competition between its member organizations as far as interest rates are concerned.

## THE LEASING INDUSTRY

The development finance institutions (DFI), which are either public sector or para-statal in character, have extended into direct competition with private companies engaged in leasing, with the following competitive advantages:

(a) They enjoy concessionary funding from the World Bank and other such lending institutions;
(b) They bear no exchange risk on their borrowing from such sources, as the risk is borne by the Central Bank;
(c) They do not have to pay turnover tax on their leasing income. There seems to be an anomaly in the tax treatment of leasing companies, development finance institutions and commercial banks with regard to the levy of turnover tax.

Leasing companies have to pay 3 per cent on their total lease rental, which includes both capital and interest. Commercial banks pay 5 per cent only on their interest. Development finance institutions do not pay any turnover tax whatsoever.

There seems no reason why the disparity should not be abolished by charging the development finance institution a 3 per cent turnover tax on their leases. No longer can it be argued that they are playing an exclusive developmental role and should therefore be given preferential treatment. It is well known that among their biggest customers are some multi-nationals and large Sri Lankan companies to whom they lend in competition with the commercial banks. As far as leasing is concerned, development finance institutions are in direct competition with leasing companies over whom they have the advantage of both concessionary funds and preferential taxation.

The suggestion that the Government should levy 3 per cent on leasing done by development finance institutions has the added merit of broadening the tax base (thereby increasing government revenue) and levelling the unfair competition between the State (and para-statal institutions) and the private sector, a matter on which the International Bank for Reconstruction and Development and the Asian Development Bank have expressed strong views.

## INTERNAL TRADE

There are two government organizations in charge of various aspects of internal trade in Sri Lanka - the Commissioner of Inland Trade and the Fair Trading Commission. They work together, as required by government policy, in

order to ensure that the consumer is not only protected from the anti-competitive practices of various dealers and shops, but also to see that consumer needs are supplied at a reasonable price and quality.

For a long time, unlike some developing countries, Sri Lanka had in place a well-established distribution system throughout the island, managed by both government organizations and the private sector, covering rail and road transport, and having local agents to distribute goods. The cooperative organization has its own distribution system throughout the country. In the war-torn areas in the north and north-east, however, the distribution system had nearly broken down during the past few months.

The cooperative organization with its sales outlets in every part of the island offers keen competition to the private sector. When traders see the quality of goods and the prices at which they are sold by the cooperative shops, the private sector finds it difficult to sell at a high price or unload substandard goods. In addition to the cooperative outlets and the private shops, there are weekly Sunday fairs in every part of the country. These give consumers an opportunity to obtain their weekly requirement of goods, including food items. Sunday fairs also provide an opportunity for villagers, and townspeople to sell their excess supply of garden crops at a reasonable price. No registration or licence is required to sell such items as home-made garments and similar articles. They have only to pay the local costs to the local authorities who control these trade fairs.

No system has been organized by the Government or by any responsible association to collect the produce of farmers, especially perishable fruits and vegetables which have to be disposed of within one or two days of harvesting. Farmers have to sell their produce to the local collectors on credit. The local collectors send them to the dealers in the central market where they have to obtain the assistance of the market operators. The farmer gets his money only after the sale of his produce at the central market and deduction of various commission charges, transport costs, etc. Very often the farmer does not get even one-fourth of the selling price. Under this system, the farmer has no alternative but to accept whatever price the local collectors will pay. These local collectors operate areawise, and therefore there is no competition among them at all.

The position in regard to spices is even worse. Local collectors go on advancing money to farmers so that they may continue to be indebted to them and give their crop at whatever price the collector offers. The international price or the export price is not reflected at these buying points. Under the new development policy measures, the Government has now taken a decision to establish buying centres in the producing areas which can have direct contact with exporters and wholesalers.

## TIED PURCHASING

Tied purchasing from a firm related to the parent company is not unusual. Some firms purchase their raw materials from sister companies at special prices. If firm X is asked whether the raw materials it purchases from its sister firm Y would be available to other firms at the same price, Xreplies that firm Y produces the raw materials it needs according to a special formula to ensure the quality of the product. Naturally firm X would not want raw materials made to its formula to be offered to its competitors.

## COLLUSIVE TENDERING

Government purchases have to be made on a tender basis, except for day-to-day requirements of low cost miscellaneous items. All imports by the Food Commissioner's Department and the Fertilizer Corporation are made on a world-wide tender basis. The Government has appointed Tender Boards to go through the tender procedure, to examine the offers received and to make purchases from the most favourable source. Apart from the considerations of price they have to give equal weight to delivey terms and the quality of goods. Government organizations have to award contracts by tender in other areas as well.

There have been collusive offers by suppliers on these tenders. As a buyer, the Tender Board had to ignore such practices and take the most favourable offers. Offers on tender for construction of building complexes, roads and development projects come very often with financial assistance, gifts of machinery and loans. Here again the Tender Board has to award the tender on merit alone.

There are regular purchases by the Government organizations for which they have to select the supplier on tenders annually. One good example is the requirement of meat for the zoo: very often it is the same supplier, who is in a position to get the supply organized, who is the one awarded the contract. It is difficult to prevent this practice, as the buyer has to assure an uninterrupted supply at a reasonable price. Nevertheless, whenever the tendering authority finds that the offers received are not competitive, it has the right to cancel the tender.

According to the Head of the Government supplies organization, collusive tendering has been practised in the past by suppliers of electric bulbs, PVC wire, blackboard chalk, sealing wax and a few others.

The one and only tenderer for the supply of automotive batteries has quoted the same price for the past few years. In some instances, owing presumably to a tacit agreement between the suppliers, only one firm tenders in response to the invitation to tender, for example for PVC pipes, PCV cables, etc. In another instance, such as for the manufacture and supply of sealing wax, both firms quoted an identical price. This could indicate collusion between them. When tenders are used for the supply of PVC wire, only one firm, submits tenders, although there are two large firms - Associated Cables and Kelani Cables - in this industry.

In the construction industry so far there has been no evidence of collusive tendering among local contractors for locally-funded projects. Competition is so severe that tenderers have been known to quote well below the Government engineer's estimates. In some cases, quotations were only 60 to 70 per cent of the estimated cost of the project.

However, in the case of projects funded by foreign agencies - Asian Development Bank (ADB), the International Bank for Reconstruction and Development (IBRD) and the OCEF - the funding agency, in consultation with the department concerned, makes a short list of some five firms among those expressing interest in the project, but, finally, only one of these actually puts in a tender. This could be considered collusion.

## INTERNATIONAL TRADE

As a member of a number of international organizations and service organizations, Sri Lanka has to maintain certain standards. Nevertheless, some aspects of Sri Lanka's export trade have to be commented on here.

Reference was made earlier to the tea auction system where everyone can obtain their requirement of tea of various grades for a particular blend at the same price. But what happens thereafter is quite different. Some exporters of tea offer the same blend as that supplied by their friends (who participated at the auction) to their buyers at a lower price, sometimes even below the cost. Though international trade depends on friendship and confidence built up over the years, there are some buyers, particularly new buyers, who would like to obtain quality grades at a lower price. Very often exporters succeed in obtaining supply contracts from such buyers abroad. They send one or two shipments of high quality grades then gradually lower the quality by using a higher percentage of low-quality tea in the blend in order to cover costs and maintain a profit margin. In so doing, the country's image abroad as a reliable supplier becomes tarnished. Sri Lanka has lost several buyers abroad because of such practices by some exporters. There is provision to blacklist these exporters, but it is very seldom that foreign buyers actually complain about them. This is not an issue of competition, however, but rather one of controlling fraudulent activities and substandard goods.

In the past, a shortage in weight of some exports, particularly of cinnamon, has been observed when it reaches low humidity countries in the North, even though shippers have kept to the correct weight at the point of shipping. Certain produce becomes drier after arrival in a low humidity climate. In order to overcome this shortfall in weight, the Government is nowpermitting a certain percentage over and above the weight to cover this loss. Such practices are acceptable in international trade although, at first glance, they may seem to be unfair trading practices.

## OCEAN FREIGHT

In the early 1970s, Sri Lanka faced numerous difficulties in obtaining cargo space for export goods both in conference and liner vessels, particularly for dirty cargo such as coir fibre, graphite and coconut shell charcoal. Not only did shipowners refuse to carry them but there were frequent increases of general freight rates which made Sri Lankan exports uncompetitive on foreign markets vis-à-vis similar goods on the same market from competitors. Official representations made to shipowners produced very little results. Sri Lanka shippers were forced to accept these increases as they did not have any alternative. In order to overcome this situation, the Government established the Ceylon Shipping Corporation in 1971 and purchased a few vessels.

The next step taken by the Government was to establish a Central Freight Bureau, in 1973, with a view to providing a central freight booking office for allocation of space for goods on any vessel to be shipped from Sri Lanka's ports, ensuring aggregation of cargo in economic loads, rationalizing regular services for the shipment of cargo and fostering the national merchant fleet. Other objectives were improving Sri Lanka port performance, loadingrate, handling of cargo, negotiations with shipowners and shipping lines on freight rates, surcharges, adequacy, frequency and efficiency of shipping lines for carriage of cargo from Sri Lanka ports, reducing costs by shippers and undertaking research on shipping which would, in the long run, help shippers and promote Sri Lankan exports abroad.

Since the establishment of the Central Freight Bureau, shippers have not had much difficulty in obtaining shipping space for their cargo at a reasonable, established rate of freight. However, the foreign shipowners and their local agents began to protest when they could not enjoy the same benefits as before. The Sri Lanka Shippers' Council worked in close association with the Central Freight Bureau as they experienced a spectacular and unprecedented increase in shipping opportunities. Earlier, they had found it difficult to obtain space on vessels calling at Colombo Port. Following the establishment of the Central Freight Bureau, the very same vessels were competing to obtain cargo through the Bureau.

Under the liberalization programme of the present Government, ocean freight was also liberalized with effect from 1 January 1990, except for the northern European sector. Immediately after the liberalization of freight, sharp competition began among the steamer agents to secure cargo for the vessels they represented; as a result, freight rates have dropped by about 30 per cent. This lower rate may not last long. Already Ceylon steamer agents have given notice to the Shippers' Council of an increase in freight rates. These increases are likely to come in stages with no competition among themselves and gradually they may move back to the old practice of offering rebates and discounts to the shippers and transferring the rebates in foreign exchange to bank accounts abroad - a restrictive business practice.

## RESTRICTIVE BUSINESS PRACTICES IN AIR TRANSPORT

Commercial airline operations - whether passenger or cargo, both to and from Sri Lanka - are subject to the approval of the Director of Civil Aviation who, in turn, decides on the recommendation of Air Lanka Limited, the national carrier.

Air Lanka presently operates three L10 Lockheed and one Boeing 737 aircraft on the following routes:

| | | |
|---|---|---|
| (a) | European services: | London, Paris, Frankfurt, Zurich, Amsterdam, and Rome; |
| (b) | Middle East services: | Dharan, Riyadh, Kuwait, Bahrain; |
| (c) | Indian sub-continent: | Karachi, Bombay, Madras, and Trivandrum; |
| (d) | South-east Asia and Australia: | Bangkok, Kuala Lumpur, Singapore, Melbourne and Sydney; |
| (e) | Far East: | Hong Kong, Tokyo. |

Aircraft schedules are very tight and are heavily dependent on good maintenance facilities and ground handling operations.

With regard to passenger movement, several European tour operators have complained about:

(i) The unsuitability of Air Lanka's departure and arrival times for flights from Paris and Amsterdam for tour groups to Sri Lanka. Therefore, they have requested traffic rights to operate their own charters. This request seems to have been rejected by Air Lanka. Since the tour operators will create new markets, Sri Lanka's hesitancy may stifle competition and restrain the growth of the tourist industry.

(ii) There have been continuous complaints from Pakistan International Airlines against the restrictions imposed on their uplifts ex-Sri Lanka.

(iii) In view of the restrictions which Sri Lanka wanted to introduce, Singapore Airlines changed their operational patterns to Sri Lanka. At present they only operate flights from Sri Lanka to Singapore and vice versa. Sri Lanka has lost Singapore Airlines' contribution to the Sri Lanka tourist industry from European destinations.

With regard to cargo transport, Sri Lanka exporters are adversely affected by the following:

(i) Air Lanka does not operate specialized cargo charters. The export industry would welcome regular freight operations which will enable exporters to be flexible. In fact, the Flying Tiger Airline offered to operate regular freight services to Colombo. On account of Air Lanka's objection, these flights were diverted to Bangkok. Thailand's air capacity expansion is closely linked to her export boom.

(ii) It is not possible to obtain flight space from charter/freighters with short notice and every year during the high season Sri Lanka exporters experience great difficulty for want of space. This has affected adversely the export drive of the country.

(iii) Air Lanka does not permit charter/freighters to bring inbound cargo. Since freight operators quote rates based on the utilization of space, this too increases the ultimate cost to the exporters.

(iv) Air Lanka's handling charges at the airport seem to be excessive. Since it has a monopoly on handling in Colombo, no controls are exercised. This makes operators shy away from Colombo as a point of flying operations.5/

## MARKET RESEARCH

Market research abroad for Sri Lanka's exports is efficiently carried out by our commercial representatives abroad. Their market research covers the entire area for a product, including packaging requirements, health standards and quality. This research helped Sri Lanka to introduce a large range of new products to the foreign market. These market survey reports are made available to exporters, various trade associations, and even to universities at their request, free of charge. Market research is done by the Export Development Board as well, covering both the local availability of a product and the market potential for a product abroad. Few anti-competitive practices have been uncovered in the market research reports we have seen.

## AUDITING

It is a requirement under the Finance Act No.39 of 1971 for the Auditor General to audit all Government corporations and business undertakings every year for the purpose of highlighting deficiencies and shortcomings of the organization. Under section 13 (17) (a) of the Act his audited report has to be submitted to the Public Accounts Committee. Any cash surplus has to be deposited in the Treasury.

Private sector auditing of companies is quite different. Every company registered with the Registrar of Companies has to file its audited accounts annually with the Registrar. These companies are audited by registered, professionally qualified accountants and their auditing helps the company to improve its operations and income. We have not discovered any restrictive business practices in the field of auditing.

## NOTES

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